UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF MONTANA

In re **STAN W. MOCK, and** **BEVERLY J. MOCK,** Debtors.	Case No. **05-61157-11**

MEMORANDUM OF DECISION

At Butte in said District this 26th day of September, 2005.

Pending in this Chapter 11 bankruptcy case are: (a) the motion to modify stay and for *in rem* relief filed on May 16, 2005, by First State Bank of Thompson Falls ("First State Bank"), and Debtors' objection thereto; and (2) Debtors' Application to approve employment of TLC Engineering, PE, LLC ("TLC") as civil engineer and planner for the Debtors, filed May 26, 2005, and objection thereto filed by First State Bank. Hearing on these two matters was held after due notice at Missoula on July 7, 2005. Debtors were represented at the hearing by attorney Gregory E. Paskell ("Paskell"), and Debtor Stan W. Mock ("Stan") testified. First State Bank was represented by attorney David B. Cotner ("Cotner"). Other witnesses testifying included timber appraiser Ken Stephens ("Stephens"), real estate appraiser Mark Manley ("Manley"), Mike Duffield ("Duffield"), Robert Fletcher ("Fletcher"), and TLC licensed professional engineer Scott Curry ("Curry"). First State Bank's Exhibits ("Ex.") 1, 2, 3, 4, 5, 6, 6A, 7, 8, 9, 10, 11, 12, 13, 14, 15, 16, 17, 18, 19, 20, 21, 23, 24, and 25 and Debtors' Ex. A, all were admitted into evidence. Ex. 22 was admitted subject to qualification that Debtors dispute the amounts of the

claims stated thereon. At the conclusion of the parties' cases-in-chief the Court closed the record and granted the parties time to file briefs, after which First State Bank's motion and Debtors' Application to employ TLC would be taken under advisement. The parties' briefs have been filed and reviewed by the Court, together with the record and applicable law. These matters are ready for decision.

This Court has exclusive jurisdiction in this Chapter 11 case under 28 U.S.C. § 1334(a). First State Bank's motion to modify stay and for *in rem* relief and Debtors' Application to employ TLC are core proceedings under 28 U.S.C. § 157(b)(2). For the reasons set forth below, First State Bank's motion to modify stay will be granted but its request for *in rem* relief will be denied, and Debtors' Application to employ TLC will be granted, by separate Order, provided that no compensation will be paid to TLC without the filing of an application for compensation, including contemporaneous and detailed billing records by TLC, in compliance with Mont. LBR 2016-1 and Montana Local Bankruptcy Form ("LBF") 17.

FACTS

Debtors Stan W. Mock and Beverly Mock (together "Mocks" or "Debtors") were married but divorced in 1972[1]. Since 1996 they have owned 180 acres of real property located near Heron, Sanders County, Montana (hereinafter the "Heron property"), of which approximately 120 acres has marketable timber. Two sides of the property are bordered on a county road. It has good views, a barn with power, one hand-dug well, 2 ponds and an old unused septic system. Stan testified that he logged the property 2 or 3 years ago to clear right of ways. He has not dug any water wells.

[1]Ex. 17, pp.7-9 is Stan's testimony from a Rule 2004 examination. Stan and Beverly still live together and file joint tax returns. Stan believes they are common law married.

Stan testified that he works installing utilities for major utility companies such as Qwest and AT&T. He testified that he owns Mock Underground, Mock, Inc., and is partial owner of Pacific Western ("Pac West"), all of which entities are in the business of installing underground utilities. Stan testified that he and Beverly have not prepared or filed their personal income tax returns for the years 2001, 2002, 2003, and 2004, and have not filed corporate tax returns for Mock, Inc., for those same years. Stan stated he understands the need to prepare and file his tax returns and he is working with his bookkeeper to get the returns filed. On Ex. 17, Stan's Rule 2004 examination transcript, Stan testifies at pages 62 to 64 that CPA "Michael Fuss is going to handle that as soon as he can, as soon as we can provide the money to do it." Ex. 17, p. 62. Stan's Rule 2004 testimony goes on to state that he is sure that Fuss will agree to continue to provide work, but only when his outstanding bill is paid. Ex. 17, p. 62.

First State Bank made two loans to the Mocks and other loans to their corporation Mock, Inc., all of which were secured by the Heron property including timber, Ex. 6, as well as Mocks' personal guarantees, and the loans were cross collateralized. The first loan to Mocks was a $150,000 operating line of credit, which was refinanced with a second loan. Fletcher is First State Bank's senior vice president and counsel. He testified that First State Bank has not received any payment from the Mocks since 2001.

Mocks listed their Heron property for sale on May 27, 2004, in a multiple listing service through Coldwell Banker Resort Realty at an asking price of $1,250,000, including "lots of timber", as a single unit. Ex. 12.

First State Bank initiated foreclosure proceedings in state court, but the action was removed to the United States District Court for the District of Montana, Missoula Division, , Cause No. CV-02-119-M-DWM (the "foreclosure action"). Fletcher testified that First State

Bank was awarded summary judgment in the foreclosure action. Ex, 2 is an amended and final judgment, decree of foreclosure and order of sale entered in the foreclosure action on February 7, 2005. Ex. 2 awarded First State Bank a "First Position Judgment" against Mocks in the sum of $549,777.83 plus $ 2,260.00 costs and $47,465.60 in attorney's fees, with a first lien position against the Heron property[2] superior to any lien or interest of any other Defendant[3]. Fletcher testified, however, that First State Bank's first lien position is junior to the tax lien of the Montana Department of Revenue ("DOR")[4].

An "Additional Judgment" against Mocks was entered in Ex. 2 on their personal guarantees of corporate debt in the total amount of $229,313.09, of which $73,043.45 plus accruing interest is superior to the other Defendants except for the IRS's lien, and the remainder of $156,269.65 is not secured by the mortgage. Ex. 2, p. 4. Mocks filed an appeal of the judgment shown by Ex. 2 with the United States Court of Appeal for the Ninth Circuit.[5]

First State Bank asked for a marshal's sale, and Fletcher testified that a sale was scheduled for late April of 2005. On the eve of the marshal's sale Debtors, represented by Paskell, filed a voluntary Chapter 13 petition on April 19, 2005. They moved to convert the case to a case under Chapter 11 on April 25, 2005, which the Court granted by Order entered May 9, 2005, after no objection was filed. First State Bank filed its motion on May 16, 2005, requesting

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[2]The complete legal description is provided on Ex. 2, p. 3, along with an address of 108 Upper River Road, Heron, Montana 59844.

[3]Defendants named in Ex. 2 include the Internal Revenue Service ("IRS").

[4]The DOR was not a named defendant in the foreclosure action. Ex. 1 is the DOR's warrant for distraint filed October 28, 1999, in Sanders County.

[5]First State Bank has been granted relief from the stay to defend the Debtors' appeal of the judgment of foreclosure, by Order entered August 18, 2005.

relief from the stay under 11 U.S.C. § 362(d)(1) and (2) and in addition *in rem* relief so that the stay would not apply if either or both Debtors file a subsequent bankruptcy petition.

Debtors filed their Schedules and Statements on May 19, 2005, listing assets totaling $2,602,390.00 and total liabilities of $1,131,642.93. Schedule A lists real property described as "Heron property, 180 acres and timber – Sanders County" at 108 Upper River Road, Heron, MT, valued by Debtors as having a current market value of $2,000,000 and encumbered by secured claims totaling $690,000.00. Schedule B lists personal property totaling $602,390, including $15 cash and $0 in two checking accounts, $75,000 representing 100% ownership in Mock, Inc., which includes heavy equipment, and accounts receivable of $400,000 owed by the City of Jolette [sic] and $120,000 owed by "Claims – Crawford". Schedule C lists Debtors' exemptions including a $100,000 homestead claimed in the $2,000,000 property described at Schedule A.

Schedule D lists $897,000 in secured claims, including First State Bank's claim stated as $620,000.00 secured by the 180 acres and timber, an IRS tax lien from 1996 in the sum of $207,000 which is marked as "disputed", and a $70,000 claim of Arleen Davenport secured by heavy equipment and a second mortgage on the Debtor's land. Schedule E lists priority tax claims owed to the Montana Department of Revenue in the sum of $45,000 for "taxes from 1996", and $1,051.82 owed to the State of South Dakota described as "2002 work surtax". Schedule F lists unsecured claims totaling $188,591.11, including a $14,000 claim of Michael Fuss, CPA.

Debtors' Schedule I lists Debtors' income from Stan's employment as a communications contractor for "Pacfic [sic] West Utility Contractors, Inc." ("Pac West") in the amount of $5,400 per month gross income and $3,813.00 after withholding, plus another $6,000 in other income described as "Estimated Profit Distribution from Co. (40%)" for a total income of $9,813.00.

Schedule I states Stan has been employed by Pac West for 1 week. No employment is shown for Beverly. In his Rule 2004 examination dated June 28, 2005, Stan testified that he has not received any Paychecks from Pac West. Ex. 17, p. 132. Schedule J lists monthly expenses of $1,615.00, including nothing for monthly rent or mortgage payment.

Debtors' Statement of Financial Affairs lists their income from operation of business as $165,000 in 2003 as "communications contractor (Mock Inc.) gross income, $5,500.00 in 2004 as a construction contractor, and $8,000 estimated[6] income in 2005 as a "Communication Contractor". Other income listed in the Statement at paragraph 2 is $8,995 in 2004 social security and $6,505 in 2005 social security, but states for 2005 "(no longer collects)". The Statement lists First State Bank as having a judgment for mortgage foreclosure from the district court of Sanders County, along with other litigation for breach of contract and recovery of money, and lists repossession by "Arlene Davenport" of heavy equipment from Debtors in January 2005. Paragraph 18 of the Statement lists Mock, Inc., and Pac West as Debtors' businesses, Mock, Inc., since 1996 and Pac West beginning in May 2005.

Debtors filed their application to employ Paskell as attorney on May 23, 2005, which was granted the same date. Paskell temporarily withdrew as Debtors' counsel for one month by Notice filed June 21, 2005, and was replaced by attorney H. James Oleson ("Oleson"). Oleson withdrew as Debtors' attorney by Notice filed July 13, 2005, and Paskell resumed as Debtors' attorney including for the hearing on July 7, 2005. Subsequently, however, Paskell moved to withdraw as Debtors' attorney on August 3, 2005, after filing their post-hearing brief. After hearing the Court granted Paskell's motion to withdraw by Order entered on August 18, 2005,

[6]In his Rule 2004 examination Stan testified that he has not received any of that $8,000. Ex. 17, pp. 124-25.

and granted Debtors thirty (30) days to obtain new counsel or they shall be deemed to proceed *in propria persona*. No new attorney for Debtors has filed a notice of appearance or application for employment.

Debtors filed their application to employ TLC on May 26, 2005, with a motion for approval thereof, to investigate Mock, Inc.'s claims against the City of Joliet, and to investigate and engineer a subdivision of Debtors' real property at an hourly rate of $40 to $150. First State Bank objected to Debtors' application to employ TLC for purposes of Mock, Inc., because it is not a debtor, and because of the broad range of TLC's requested fees and proposed subdivision of First State Bank's collateral as First State Bank believes Debtors lack equity and no means exist to pay TLC's fees or provide adequate protection. At hearing, Paskell admitted and agreed that Debtors' employment of TLC should be limited to the Debtors' personally and not include any services for Mock, Inc.

Proofs of Claim totaling $1,293,004.68 have been filed in this case, including $1,051,886.09 in secured claims. First State Bank filed Proof of Claim No. 6 on May 11, 2005, asserting an unsecured claim of $168,412.21 and a secured claim of $740,278.05, secured by real estate with a value stated of $1,200,000. The IRS filed Proof of Claim No. 7 on May 23, 2005, asserting a secured claim of $211,608.04 for 1996 taxes, and a priority claim of $21,647.40. The attachments to the IRS's Proof of Claim 7 state that the priority claim is estimated because Debtors have not filed returns for the years 2001, 2002, 2003, and 2004. Stan admitted in his testimony and Rule 2004 examination that Debtors have not filed tax returns for several years. "Aileen" Davenport filed Proof of Claim No. 12 on September 7, 2005, asserting a secured claim in the sum of $100,000 secured by real estate, vehicles, equipment, and accounts receivable arising from a loan to Mock, Inc. To date, no objections have been filed to the allowance of First

State Bank's claim or any of the other claims filed.

Ex. 22 is First State Bank's summary of liens against the Debtors' property, including First State Bank's liens , state and federal tax liens, Aileen Davenport's mortgage and other judgment and attorneys' liens[7]. Fletcher testified that Ex. 22 shows the total owing to secured creditors as of the date of the hearing is $1,147,492.66, with interest thereon accruing at the rate of $256.57 per day which comes to $7,804.00 per months and $93,648.05 per year. Ex. 22[8]. Fletcher testified that the after-tax proceeds calculated by Duffield on Ex. 23 discussed below would not pay secured creditors under any of his 4 scenarios.[9]

On the date of the hearing, Stan admitted on cross examination that he had no employment income, but that beginning July 15, 2005, he would be working with his Pac West crews and earning 30% of net profit and $1,000 per month. He estimated that his revenue from one crew would range from $12,000 to $15,000 per week over 3 years from Pac West which he will contribute to Debtors' Plan.

Stephens Testimony:

Debtors stipulated that Ken Stephens is an expert in the valuation of timber assets. Stephens was hired by First State Bank to appraise the timber on Debtors' property. He testified that he analyzed Debtors timber utilizing 2 methods – removal of all timber, and a "realty cut" of 65% of the timber volume on 120 acres. Stephens took an earlier 2001 timber cruise and adjusted the values by 5% per year, and prepared Ex. 5 as a timber value worksheet. Ex. 5 lists

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[7]Other liens are evidenced by Ex. 7, 8, 9, 10 and 11.

[8]Ex. 22 updates Ex. 13, a list of the secured claims on the Heron property with a total amount owing of $1,136,081.23.

[9]The $1,134,878 after tax proceeds from the sale of a principal residence by married persons comes closest, Fletcher testified, to what may be expected from sale of the Debtors' Heron property.

the value of 100% of the timber as $499,851.00, and the value of 65% of the timber is listed as $343,808.00. On cross examination Stephens admitted that his valuations were an estimate, and that the value of timber in his opinion and Ex. 14 show a wide range in timber values[10] depending on the market. Stan entered into Ex. 14, a Log Purchase Agreement with JD Lumber, Inc., of Priest River Idaho, on June 21, 2005, for the sale of Stan's timber at prices varying according to species. Stan criticized Stephens' timber appraisal because it did not delineate the value of the different timber species.

Manley Testimony:

Mark Manley is a certified general real estate appraiser who has worked as an appraiser with First State Bank since 1993. He testified that First State Bank provides him about 15% to 20% of his business. Manley focuses his business in Sanders County and the Thompson Falls area, where he testified he is the only certified general appraiser. Manly prepared Ex. 4, an appraisal of the Debtors' real property, using exclusively the sales comparison approach. Ex. 4 lists the value of the Debtors' subject property as of May 13, 2005, as $1,277,000 assuming 65% timber removal, and $753,000 if 100% of the timber is removed. Ex. 4, p. 6. Manley testified that his $1,277,000 valuation is based on marketing the Debtors' 180 acre parcel as a single unit. Manley gave an opinion of the value of the Debtors' proposed 4 or 5 acre tracts, and estimated each tract would have a value of from $45,000 to $50,000 without taking into consideration costs such as a well and septic system. He admitted that subdividing the property could increase its market value, but that costs would reduce the tract value. Manley testified that wells in the area of the Heron property generally run to depths of between 150 to 500 feet and typically cost

[10]Ex. 14 shows values ranging from $140 per thousand board feet (/mbf) for spruce to $800/mbf for cedar. Ex. 5's values were from $477/mbf to $506/mbf.

between $12,000 to $15,000 to install[11] and would reduce the value per proposed 5 acre tract to from $30,000 to $35,000.

Manley testified and Ex. 4 reflects that the soil on the subject property has a high clay content which makes excavation more difficult and increases the cost of septic systems. He testified that the county planner of Sanders County, Dan Miles, is familiar with the property and clay problems which complicate septic systems[12] and drainage. Manley testified that because of the high clay composition of the soil on the Heron property the Debtors will likely have a difficult time obtaining subdivision approval.

Duffield Testimony:

Michael J. Duffield is a certified public accountant ("CPA") with 35 years of experience. Duffield was hired by First State Bank to analyze the tax implications for the Debtors of a sale of Debtors' Heron property for the price of $1,277,000. Duffield assumed a $400,000 basis and $80,062 in closing costs. Ex. 23 sets forth Duffield's four scenarios for the tax implications of a sale. Duffield testified that he asked for the Debtors' tax returns to prepare his analysis, but that no personal or corporate tax returns have been filed by the Mocks since 2002. Ex. 23 shows the projected 2005 income tax on a sale of the Heron property ranging from $166,560 to $62,060[13]. After tax proceeds from the sale on Ex. 23 range from $1,030,378 for not principal residence to $1,134,878 for principal residence/married.

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[11]On cross examination Manley admitted he has not dug a test well. He testified that Stan told him there is 1 hand-dug well on the property.

[12]He testified that the high clay content on the Heron property would require a mound septic system at a cost of $10,000 to $15,000.

[13]The $166,560 projected tax is for sale of property which is not principal residence; if married and principal residence the tax is $62,060; if divorced/principal residence the tax is $114,310; and if 20% principal residence/80% not the tax is $133,248. Ex. 23, p.2.

Duffield testified that there was a fifth alternative, "dealer status", which results when an investor becomes a dealer of a subdivision, in which event the tax calculations on Ex. 23 would effectively double and after tax proceeds would decrease. On cross examination Duffield admitted that Ex. 23 assumes a 1 year sale, and that stretching the sales out over 3 years and deferring receipt of cash would defer taxes on the sale. Duffield testified that no bright line test exists for determining when an investor becomes a dealer, and that the chance of being characterized as a dealer is enhanced if the gain from a development is high, or if the Debtors sold all 34 tracts in 1 year.

Curry Testimony:

Curry is self-employed and a licensed professional engineer since 1994, and does business through his firm TLC which the Debtors have applied to employ as professional. Curry is not a certified appraiser[14]. His background is in development of properties while with the U.S. Forest Service, and he testified he has been the principal engineer in a couple dozen developments over the last 2 years. He prepared Ex. A, showing Phases I (Lots 1-15), II (Lots 16-25), and III (Lots 26-34) of tracts ranging in size from about 3 acres in the interior Phase 3 to 5 acres. The property's boundary on 2 sides is a county road, and an existing entrance and right of way to the center of the property is available.

Curry testified that Ex. A is designed in 3 phases to put as many lots on the perimeter on the market as quickly as possible. The first 2 phases are on the perimeter with existing public access and utilities available. He testified that the 15 Phase I lots would cost less than half to develop than the interior lots. Curry testified that the proposed 3 to 5-acre ranchettes are in big

[14]The Court sustained First State Bank's objection and found that Curry was not qualified to testify to the value of the proposed Lots.

demand and can sell quickly, perhaps as a gated-community. He estimated that all 34 lots would sell within 3 years at prices ranging between $75,000 to $125,000 per lot. Curry testified that other 5 acre parcels in Sanders County were selling for around $65,000, and that waterfront lots and lots with views sell for much more, around $100,000.

Curry testified that the proposed lots on Debtors' Heron property would be fairly simple to develop, and easier than most developments which TLC works on, because the utilities are available and Stan's crew is already installing utilities, and the Debtors' property is conducive to absorption trench drainfields. Curry drilled test holes to check for clay content. He testified that the soil is comprised of deep loam for the upper three to six feet, with increasing clay content beginning at 5 feet. Curry admitted that some areas would have problems developing drain systems but that the lots are large enough that they can accommodate the needed drainfields. Curry testified that wells in the vicinity run between 700 to 800 feet deep, but that he is not concerned about water wells on the Heron property.

With respect to costs, Curry testified that gravel pits owned next to the property by the Debtors and the County drastically reduce the cost of road building and drainfields because the required gravel material is close at hand. He estimated that engineering and surveying costs for the 34 lots would total $77,000[15], including for the road, storm water draining, health review and platting. Curry testified he wants this fee to be paid prior to approval of the subdivision.

On cross examination Curry testified that an additional $150,000 costs would be incurred for utility installation, and $165,000 for road construction if Mock gravel were available locally, plus another $76,000 if gravel must be hauled in from elsewhere at a cost of $10 per cubic yard,

[15]Curry testified that his fees are calculated by the hour depending on the task, from clerical to engineering, and runs up to $150/hr. or $2,000 per lot.

and a 5% marketing analysis fee. Curry admitted that he spoke with Aileen Davenport, who holds a mortgage on the Mocks' gravel which is owned by their daughter Stacy. According to Curry, Davenport did not say that the Debtors' could use Stacy's gravel, and that Stan wants Stacy paid for any gravel they use for the subdivision at a cost of $3 per cubic yard. Stan could not recall at trial, but at his Rule 2004 examination he testified that Stacy would be paid for a portion of her gravel, and Stan would be paid only for his services. Ex. 17, pp. 110-11.

Curry estimated the length of time to get subdivision approval would include data collection and calculation, submission to the Montana Department of Environmental Quality and County Planning Dept., with the Debtors most likely ready to sell the first lots with approval by the summer of 2006. Curry acknowledged a year-and-a-half to 2-year period was required for approval of a subdivision he worked on in the Trout Creek Ranger District in 2002-2003, but he asserted that approval of the Debtors' proposed subdivision would not take that long. On cross examination Curry admitted that Debtors cannot get subdivision approval in less than a year.

Other Testimony:

With respect to his daughter's gravel pit, Stan testified that Stacy owns the gravel and that it is encumbered by Aileen Davenport's mortgage. However, Stan insisted that Davenport's mortgage will be paid in full after liquidation of the equipment she repossessed, leaving the gravel free and clear to be sold. Otherwise, Stan testified that there are 2 other gravel pits nearby where he can obtain quarry rock or river rock for the development at very low prices.

Stan testified that Debtors will list their lots from Ex. A for sale for between $75,000 for the timbered lots, and up to $125,000 for the waterfront lots or those with mountain views. At that price, Stan testified, the Heron property is worth $3.3 million. He testified that wells in the area are less than 400 feet deep, and water could be provided to the subdivision if necessary from

a common well at a cost of $40,000 including tanks and a well house[16]. Debtors' plan of reorganization, according to Stan, will be to develop and sell the lots using income from Pac West and timber sales. Stan admitted that he has not personally done subdivision development before.

Stan testified that he does not have a bank account, and that at the time of trial his income was solely from social security disability and he has had no regular income except for odd jobs since 2002. In his Rule 2004 examination Stan stated that his daughter has helped support them. Ex. 17, p. 70. On redirect examination Stan explained that he told Paskell that he would go to work for Pac West within 2 weeks to a month, and Schedule I was prepared on that assumption, but Stan was unable to meet that timeline because Paskell asked Stan to get an appraiser for the 180 acres and do tax work. Stan testified that the Pac West job is there but he has had to put off beginning work because of the needs of his bankruptcy case.

He testified that he does not have an employee contract with Pac West, but he is named on the business plan and has a unit contract for his upcoming work installing underground utilities. Ex. 25. At his Rule 2004 examination Stan testified that as of that date he had no cash commitment to pay First State Bank off or fund the proposed subdivision. Ex. 17, pp. 104-05. No additional evidence of financing sources was offered by Debtors at trial.

Notwithstanding Stan's opinion of the value of the Heron property, on cross examination Fletcher would not admit that First State Bank is adequately protected even taking into account the value of the timber or subdivision. Fletcher testified that he had not had time to evaluate Debtors' proposed subdivision, and the Bank is not adequately protected because its lien is

[16]Stan admitted the pipes from a common well to each lot would be additional cost, at $4 to $5 per foot.

second priority behind the DOR tax lien and because of the amount of accruing interest.

The Court at hearing admonished the Debtors of the need to prepare and file all required federal and state tax returns, and advised them that unless taxing authorities filed Proofs of Claim showing all returns filed the Debtors would have significant problems in this reorganization. On August 2, 2005, the Debtors filed an application to employ their CPA Michael Fuss, but the Court denied the application because it was not properly signed by Debtors' attorney. No subsequent application to employ Fuss or any other accountant has been filed, and the Court to date has not approved the employment of any professional to aid the Debtors in preparing and filing their tax returns. After Paskell withdrew as Debtors' attorney of record, the Court granted the Debtors an extension until October 18, 2005, to file their Disclosure Statement.

DISCUSSION

I. Application to Employ Curry/TLC.

First State Bank objected to Debtors' Application to employ Curry and TLC because of the proposed services for a construction claim of Mock, Inc., a nondebtor, and because of the range of Curry's fees and the Bank's thin equity cushion and Debtors' inability to pay Curry. First State Bank did not address this matter in its post-hearing brief.

Debtors are authorized under 11 U.S.C. § 327(a) to employ professional persons that do not hold an interest adverse to the estate and are disinterested persons, to represent or assist them in carrying out their duties. Curry is listed in Debtors' Schedule F, but only for precautionary purposes and with a claim amount stated as $0.00. The Debtors conceded at hearing that Curry's services should be limited to the Debtors personally, and not for corporate litigation. Curry testified what his services, fees and costs would be. First State Bank offered no evidence that Curry is not a disinterested person or that he holds an interest adverse to the estate. Accordingly,

under § 327(a) the Court in its discretion overrules First State Bank's objection and approves Debtors' employment of Curry and TLC as professional[17]. First State Bank's other objections based on their thin equity cushion and adequate protection payments relate more to its motion for relief, which is addressed below, than to any reason to deny the Debtors the ability to employ the professional of their choice under § 327(a).

II. Relief from the Stay – § 362(d).

First State Bank's motion for relief from the stay is filed pursuant to 11 U.S.C. § 362(d)(1) and (d)(2), based on the balance due on its judgment, and seeks *in rem* relief to provide that the stay will not apply with respect to the Heron property if Debtors file another bankruptcy case. The Bank contends that the Debtors do not have any equity in the Heron property based on Manley's property appraisal and Stephens' timber appraisal compared with all of the liens against the property, and that reorganization is impossible since the proposed subdivision is in its infancy and Curry's testimony of development costs total an amount which Debtors lack the money to pay, and the Bank will not consent to the harvest of its timber collateral. The Bank further argues that the stay should be modified for cause including the lack of adequate protection due to accruing interest and senior and junior liens. The Bank requests *in rem* relief for one year, contending without citation to authority that Debtors' filing of a Chapter 13 petition the day before the marshal's sale shows abuse.

Debtors contend that they have equity in the property based on Ex. 13's lien total of $1,136,081 and Manley's appraisal, and that by subdividing the lots the value of the property would be $1,700,000, or $2,043,000 including the value of the appraised timber and even up to Stan's opinion of $3.3 million. Debtors admit that the subdivision has not been "purposed" to

[17]This, however, does not ensure that Curry will be paid.

the planning officials of Sanders County, but contend that sufficient detail of costs, material and data exist to show that their proposed subdivision plan is feasible and that enough equity cushion is available to cover 15 months of adequate protection. Debtors argue that Curry's testimony is undisputed that subdividing the property presents no problems due to water or septic and that gravel is available as is Stan's experience as a utility contractor and his income from Pac West.

A. § 362(d)(2) – Lack of Equity.

Under 11 U.S.C. § 362(g), a creditor has the burden of proving that a debtor does not have equity in property, while the debtor has the burden of proof on all other issues to show that the stay should not be modified, including adequate protection. *See First Interstate Bank of Billings v. Interstate Distrib. Co., Inc. (In re Interstate Distributing Co., Inc.)*, 13 Mont. B.R. 86, 89 (D. Mont. 1993) (recognizing that the burden of proof on the issue of adequate protection is on the debtor); *In re Mittlestadt*, 20 Mont. B.R. 46, 52 (Bankr. D. Mont. 2002); *In re Hungerford*, 19 Mont. B.R. 103, 133-34 (Bankr. D. Mont. 2001); *In re National Environmental Waste* Corp., 191 B.R. 832, 836 (Bankr. C.D. Cal. 1996), *aff'd*, 129 F.3d 1052 (9th Cir. 1997); *In re Syed*, 238 B.R. 126, 132 (Bankr. N.D. Ill. 1999); *In re Sauk Steel Co., Inc.*, 133 B.R. 431, 436 (Bankr.N.D.Ill.1991); 11 U.S.C. § 362(g)(2). *In re Leisure Corp.*, 234 B.R. 916, 920 (9th Cir. BAP 1999). First State Bank has the burden of proof under § 362(d)(2)(A) to show that the Debtors do not have any equity in the Heron property.

In the Ninth Circuit, for purposes of § 362(d)(2)(A) "equity" is the difference between the value of the property and all the encumbrances upon it. *In re Sun Valley Newspapers, Inc.*, 171 B.R. 71, 75 (9th Cir. BAP 1994); *Stewart v. Gurley*, 745 F.2d 1194, 1196 (9th Cir.1984). This Court determines equity as of the date of filing of the petition. *In re Farmer*, 257 B.R. 556, 560 (Bankr. D. Mont. 2000). Ex. 13 shows and Debtors agree that the total debt against the Heron

Property as of the petition date is $1,136,081.23, which is less than the value of $1,277,000 shown by the Bank's appraiser Manley assuming 65% timber removal. Ex. 4, p. 6. Use of Ex. 22's lien total of $1,147,492.66 does not change the result that Debtors have equity in the Heron property. The effect of accruing interest on adequate protection does not change the result under § 362(d)(2)(A). Since the Debtors do not lack equity, the Court need not address § 362(d)(2)(B).

B. § 362(d)(1) – Cause.

Under § 362(d)(1) the burden shifts to the Debtors to show that the stay should not be modified. *In re Mittlestadt*, 20 Mont. B.R. at 52; *Hungerford*, 19 Mont. B.R. at 133-34.

> Under 11 U.S.C. § 362(a), "[a] bankruptcy filing imposes an automatic stay of all litigation against the debtor." *Christensen v. Tucson Estates, Inc. (In re Tucson Estates, Inc.)*, 912 F.2d 1162, 1166 (9th Cir. 1990) (citing 11 U.S.C. § 362(a)), except in those cases specifically enumerated in § 362(b). The automatic stay is one of the fundamental debtor protections provided by the bankruptcy laws. It gives debtors a breathing spell from creditors. It stops all collection efforts, all harassment, and all foreclosure actions. It permits debtors to attempt a repayment or reorganization plan, or simply to be relieved of the financial pressures that drove them into bankruptcy. S.Rep. No. 989, 95th Cong., 2d Sess. 54-55 (1978), *reprinted in* 1978 U.S.Code Cong. & Admin.News 5787, 5840-41.

In re Mittlestadt, 20 Mont. B.R. at 51 (quoting *In re Westco Energy, Inc.*, 18 Mont. B.R. 199, 211-12 (Bankr. D. Mont. 2000)).

First State Bank's motion for relief from the stay is based in part upon § 362(d)(1), which allows for the granting of relief from the automatic stay "for cause, including the lack of adequate protection of an interest in property of such party in interest[.]" This Court explained the standard for modifying the stay for "cause" under § 362(d)(1) in *Westco*:

> Section 362(d), however, provides that, "[on request of a party in interest and after notice and a hearing, the court shall grant relief from the [automatic] stay" in three instances. The subsection relevant to these proceedings is § 362(d)(1), which

> allows for the granting of relief from the automatic stay "for cause".[18] What constitutes cause for purposes of § 362(d) "has no clear definition and is determined on a case-by-case basis." *Tucson Estates*, 912 F.2d at 1166. *See also Little Creek Dev. Co. v. Commonwealth Mortgage Corp. (In the Matter of Little Creek Dev. Co.)*, 779 F.2d 1068, 1072 (5th Cir. 1986) (Relief from the automatic stay may "be granted 'for cause,' a term not defined in the statute so as to afford flexibility to the bankruptcy courts.").

Westco, 18 Mont. B.R. at 211-12.

Section 362 vests this Court with wide latitude in granting appropriate relief from the automatic stay, and a decision to lift the automatic stay is within a bankruptcy court's discretion, and subject to review for an abuse of discretion. *In re Delaney-Morin*, 304 B.R. 365, 369-70 (9th Cir. BAP 2003); *In re Leisure Corp.*, 234 B.R. 916, 920 (9th Cir. BAP 1999); *In re Plummer*, 20 Mont. B.R. 468, 477-78 (Bankr. D. Mont. 2003); *Mataya v. Kissinger (In re Kissinger)*, 72 F.3d 107, 108-109 (9th Cir. 1995).

Lack of adequate protection is but one example of cause for relief from stay. *In re Ellis*, 60 B.R. 432, 435 (9th Cir. BAP 1985); *In re Avila,* 311 B.R. 81, 83 (Bankr. N.D. Cal. 2004). An equity cushion may provide adequate protection even though not a single mortgage payment has been made. *Avila,* 311 B.R. at 83; *In re Mellor*, 734 F.2d 1396, 1400 (9th Cir.1984). In *Avila* the court found the mortgagee was adequately protected by an equity cushion of 40%. 311 B.R. at 83. The court noted that "[w]here a creditor is adequately protected by a large equity cushion, the debtor would suffer a substantial loss in the event of foreclosure, and no economic harm to

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[18] Section 362(d)(1) provides:

> On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section , such as by terminating, annulling, modifying, or conditioning such stay–
>
> (1) for cause, including the lack of adequate protection of an interest in property of such party in interest[.]

the creditor would result, relief from stay should not automatically follow a default in payment." *Avila,* 311 B.R. at 84; *see In re McCollum*, 76 B.R. 797, 799 (Bankr. D. Or.1987).

Applying the above law to the instant case, the Court notes that First State Bank is protected by a significant equity cushion. Ex. 4 and 5 showing real property value of $1,277,000 and timber value of $343,808 totaling $1,620,808. The Court gives no probative weight to Stan's $3.3 million value estimate or Curry's per lot value estimate. Stan did not obtain an appraisal of the property from a certified real estate appraiser like Manley. Stan listed the Heron property in his Schedules at $2,000,000, and listed it for sale on May 27, 2004, at an asking price of $1,250,000. Ex. 12. Thus the evidence shows that Stan's valuations fluctuate wildly. While a debtor's estimate of value may be acceptable in certain cases, the Court may give little weight to an opinion if not based upon sufficient facts. *Plummer*, 20 Mont. B.R. at 478; *Hungerford*, 19 Mont. B.R. at 118-19. Manley is a certified general real estate appraiser, and his opinion on the value of the Heron property is credible and based on his physical inspection of the property. The Court gives conclusive probative weight to Manley's appraisal opinion and finds the value of the property is $1,277,000. Debtors admitted that Stephens is an expert in timber appraisal and thus the Court finds the value of the timber on the Heron property is as stated on Ex. 5, $343,808.

Comparing the total land timber value of $1,620,808 to the Bank's Proof of Claim No. 6 showing a claim of $740,278.05, to which no objection has been filed, and the DOR's lien ($56,103.10) and IRS's lien ($211,608.04 estimated), the Court finds the Bank has an equity cushion of approximately $612,818.91. Junior lienholders fare more poorly according to their priority, and Ex. 22 shows that interest on the total liens eat away at the equity cushion at the rate of $256.57 per day and $93,648.05 per year, which is an inexact amount because not only do Debtors dispute the lien amounts on Ex. 2, but the IRS and DOR have estimated tax claims based

upon Debtors' failure to file tax returns. For that reason, notwithstanding the equity cushion shown, in this Court's wide exercise of its broad discretion the Court finds sufficient cause shown to grant the Bank's motion to modify stay under § 362(d)(1) based on the Debtors' failure to file their tax returns and unlikelihood that they will be able to fund their proposed subdivision.

In proposing a Chapter 11 Plan the Debtors haves the burden of proving that their plan complies with the requirements for confirmation, including Section 1129(a)(3) which dictates that a plan must be "proposed in good faith and not by any means forbidden by law." 11 U.S.C. § 1129(a)(3). In discussing good faith in a Chapter 13 case, *In re Carlascio*, 16 Mont. B.R. 429, 437 (Bankr. Mont. 1998), this Court noted the BAP's guidance in *Street v. Lawson (In re Street)*, 55 B.R. 763, 764 (9th Cir. BAP 1985) where it held that "the court must be guided by equitable doctrines *and must consider such things as the public interest.*" (Emphasis added). The same equitable doctrines apply in cases under Chapter 11. It is not, in this Court's view, in the public interest to allow debtors who fail to undertake their burdens under the Internal Revenue Code or corresponding state revenue laws to enjoy the benefits of the United States Bankruptcy Code. Debtors' attempt to repay obligations by means of a Chapter 11 plan of reorganization without having filed all required tax returns is contrary to § 1129(a)(3)'s requirement that the plan be proposed "not by any means prohibited by law."

Debtors seek several years in their yet-to-be-filed Chapter 11 plan to complete the subdivision and sell lots before the creditors can be paid, while interest accrues at the rate of several hundred dollars each day. Debtors argue that the costs of development of the subdivision will not be high and can be reduced by Stan's experience as a utility contractor and income from Pac West, and local available gravel. However, the Debtors has not fulfilled their burdens of Chapter 11 relief such as filing tax returns as required under applicable law, and therefore

Debtors are not entitled to the benefits of Chapter 11 or any longer period protected by the automatic stay.

The Court notes further that the Debtors do not have any resources shown by credible evidence to fund their subdivision development. Curry expects to be paid his fee of approximately $77,000 before subdivision approval. The evidence shows that Debtors' daughter expects to be paid for her gravel, which remains encumbered by a creditor's lien. Wells, roads and other costs and fees required for the subdivision require payment of money. Stan admitted he has not obtained any financing. First State Bank has stated it will not consent to the sale of its timber collateral, and no motion to use collateral has been filed by Debtors. Their other assets consist largely of uncollected accounts receivable.

At the time of trial neither Stan nor Beverly had any regular income, and other than a few small jobs and social security disability income Stan testified he has not had regular income since 2002. Debtors' Schedule I and Statement of Financial Affairs, signed under penalty of perjury, reflect otherwise that Stan earns monthly wages of $5,400 which he testified he was not earning. Stan's excuse that he could not begin work with Pac West because of the demands of this bankruptcy is no excuse for including incorrect information of his income on his Schedules and Statement of Financial Affairs. Debtors have no money, assets, income or financing to accomplish their subdivision, which will not take place under Chapter 11 without their tax returns being filed[19].

Finally, the record shows that Debtors' failure to file their tax returns has not, and perhaps cannot, be rectified. Stan's 2004 examination testimony is that Michael Fuss will work on

[19]The problems of granting clear title to subdivision lots which are the subject of a recorded judgment of foreclosure are obvious, absent reorganization or settlement with the Bank.

Debtors' tax returns, but only when his outstanding bill is paid. Ex. 17, pp. 62-64. Schedule F lists a $14,000 claim of Michael Fuss, CPA. As a creditor with a prepetition claim Fuss is not a "disinterested person" under 11 U.S.C. § 101(14)(A) and the Debtors-in-Possession may not employ Fuss under § 327(a). *In re Boese Wood Product, Inc.*, 19 Mont. B.R. 464, 465-66, 468-70 (Bankr. D. Mont. 2002), *quoting In re CIC Inv. Corp.*, 175 B.R. 52, 55-56 (9th Cir. BAP 1994). Fuss's Application for employment was denied[20] and has not been refiled, and because Fuss is not a disinterested person and the evidence shows he does not waive his prepetition claim and expects to be paid before completing Debtors' several years of tax returns, he cannot be employed by the Debtors. *In re Boese Wood Product, Inc.*, 19 Mont. B.R. at 470. Debtors offer no alternative for satisfying their obligations to file tax returns, and are now proceeding *in propria persona.*

Based upon the evidence and applying its wide latitude and discretion, the Court finds and concludes that the Debtors failed to satisfy their burden of proof under § 362(d)(1) to show that First State Bank's motion for relief from the stay should not be granted for cause. *In re Delaney-Morin*, 304 B.R. at 369-70; *In re Leisure Corp.*, 234 B.R. at 920; *Plummer*, 20 Mont. B.R. at 477-78*; In re Kissinger*, 72 F.3d at 108-109. The Debtors have burdens under the Bankruptcy Code which are necessary for them to satisfy in order to enjoy its benefits such as the automatic stay. In the Court's view, Debtors' prolonged failure to file tax returns reflects a failure to carry their burdens to continue to enjoy the benefits of the automatic stay.

Granting relief from the automatic stay returns the parties to the legal position which they enjoyed prior to the imposition of the stay. *In re Johnson*, 17 Mont. B.R. 318, 319 (Bankr. D.

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[20]The Court notes that Fuss signed an affidavit of disinterestedness attached to his filed employment application, which asserts he is a disinterested person and does not include the existence of his prepetition claim.

Mont. 1999); *Estate of B.J. McAdams v. Ralston Purina Co.*, 154 B.R. 809, 812 (N.D. Ga. 1993). Thus, while the Court has flexibility in determining whether to grant First State Bank's motion for relief from the stay, by granting the motion Debtors retain whatever claims, defenses and remedies they may have against First State Bank in this or any nonbankruptcy forum, including their rights on appeal.

III. *In Rem* Relief.

Turning to First State Bank's request for *in rem* relief, the Bank seeks relief from the stay for one year, contending without citation to authority that Debtors' filing of their Chapter 13 petition the day before the marshal's sale shows abuse. Pursuant to 11 U.S.C. § 105(a), the bankruptcy court is authorized to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title . . . . or to prevent an abuse of process." *In re Reinertson*, 241 B.R. 451, 455, 18 Mont. B.R. 72, 77 (9th Cir. BAP 1999).

> An in rem order, which imposes an equitable servitude on the real property at issue, is an extraordinary remedy that should be granted only in extraordinary circumstances. Such extraordinary circumstances arise, in the relief from stay context, only where an ordinary relief from stay order will not be effective, as demonstrated by the prior history of the parties and the property.
>
> The Court finds such extraordinary circumstances in this case, where (1) the debtor received a joint interest in the property with other strangers to the transaction with Great Western who may file bankruptcy cases; (2) this transfer occurred after a previous transferee from the original borrower had filed a bankruptcy case; and (3) the court had granted relief from the automatic stay to the moving party herein in that prior case. Furthermore, the joint ownership of the property among four individuals (and a corporation) indicates to the Court that the owners have planned further mischief to prevent Great Western from foreclosing if extraordinary relief is not granted. Thus the Court finds that this is an appropriate case for granting in rem relief.

In re Snow, 201 B.R. 968, 976 (Bankr. C.D. Cal. 1996). A later court construed *Snow* in describing *in rem* relief as "a nontraditional form of equitable servitude that would run with the

land for the benefit of the creditor and that would bind all subsequent transferees of the property for a specific period of time. [*Snow*] at 974." *In re Golden State Capital Corp.*, 317 B.R. 144, 150 (Bankr. E.D. Cal. 2004).

Applying *Snow* to the instant case, the Court finds that First State Bank failed to show evidence of any of the three *Snow* factors, or any other extraordinary circumstances warranting *in rem* relief. The mere fact that Debtors filed their petition on the eve of a foreclosure, standing alone, is not determinative nor does it establish "cause" under 11 U.S.C. § 349(a) or bad faith. *In re Wyatt*, 317 B.R. 159, 163 (Bankr. D. Idaho 2004) (Chapter 13). The undisputed value of Debtors' property is evidence that Debtors could have ability to enjoy the benefits of bankruptcy reorganization if they satisfied the burdens. The Court finds and concludes that this is not an appropriate case for granting *in rem* relief.

CONCLUSIONS OF LAW

1. This Court has original and exclusive jurisdiction over this Chapter 11 bankruptcy case under 28 U.S.C. § 1334(a).

2. The motion for *in rem* relief from the automatic stay filed by First State Bank and Debtors' motion to approve Application to employ Scott Curry and TLC Engineering, PE, LLC, as civil engineer and planner for Debtors, both are core proceedings under 28 U.S.C. § 157(b)(2).

3. Debtors satisfied their burden of proof under 11 U.S.C. § 327(a) to employ Curry and TLC, given Debtors' concession at hearing that the scope of TLC's employment shall be limited to the Debtors personally and not to Mock, Inc., or other corporate matters.

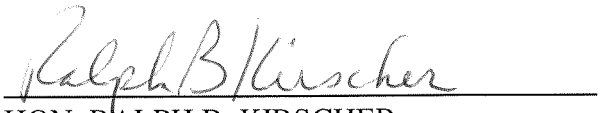
4. The Debtors failed to satisfy their burden of proof under 11 U.S.C. §§ 362(d)(1) & (g)(2) to show that relief from the automatic stay should not be granted.

5. First State Bank failed to satisfy its burden of proof to show that it should be granted

in rem relief.

IT IS ORDERED a separate Order shall be entered overruling First State Bank's objection and granting Debtors' motion and application to employ Curry and TLC as civil engineer and planner, with all compensation to said professional subject to approval of this Court upon application in accordance with Mont. LBR 2016-1 and LBF 17; and overruling the Debtors' objection and granting First State Bank's motion for relief from the automatic stay under 11 U.S.C. § 362(d)(1), but denying First State Bank's motion for *in rem* relief.

BY THE COURT



HON. RALPH B. KIRSCHER
U.S. Bankruptcy Judge
United States Bankruptcy Court
District of Montana